

## client alert

CONTRACT LAW | HONG KONG |

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### IMPACT OF THE CONTRACTS (RIGHTS OF THIRD PARTIES) ORDINANCE

The Contracts (Rights of Third Parties) Ordinance (Cap. 623) (the "**Ordinance**") was passed and gazetted on 4 December 2014 (Ord. No. 17 of 2014). However, the Ordinance is not yet in force and its start date is yet to be announced.

The Ordinance enables contracting parties to enforce contracting rights on third parties and as such, reforms the current law in Hong Kong and the age-old doctrine of "privity of contract."

With this reform, Hong Kong is following in the footsteps of other common law jurisdictions (namely, England & Wales, Australia, New Zealand and Singapore) that have long adopted third party contractual rights legislation.

#### REFORM OF THE DOCTRINE OF PRIVACY

Under the doctrine of privity, only contracting parties may enforce rights under a contract. A person cannot acquire or enforce rights under a contract to which he/she is not a party. This has long been criticised as too strict, and contrary to what the parties might intend in the contract. This is particularly so in cases where the contracting parties intended to confer benefits upon a third party.

#### SUMMARY OF THE ORDINANCE

The Ordinance is based on the United Kingdom's Contracts (Rights of Third Parties) Act 1999. Third party rights will only apply to contracts entered into **on or after** the Ordinance takes effect.

#### Enforceability Test

A third party may enforce a term under a contract if:

- the contract **expressly provides** that the third party may do so; or
- the term **purports to confer a benefit** on such third party.

The second part of the enforceability test is not satisfied if:

"On a proper construction of the contract, it is clear that the contracting parties did not intend that term be enforceable by the third party."  
(s. 4(3) of the Ordinance)

Third parties must also be expressly identified in the contract by name, as a member of a class (e.g. subsequent owners), or by a particular description (e.g. the owner's nominee) (s. 4(2) of the Ordinance).

## **Opt-Out and Assignment Clause**

Importantly, contracting parties may opt to contract out certain terms and provisions by expressly excluding the application of the Ordinance in a contract.

Further, if the contracting parties do not intend for any benefit conferred on specified third parties under the contract to be assignable in future, they should include a term to this effect in order to make sure that such third party's right under the contract is personal and not assignable.

## **Remedies**

The Ordinance provides that a third party enforcing a contract term under the Ordinance would have the same remedies in an action for breach of contract as any other party to the contract (s. 5(1) of the Ordinance).

Remedies available to the third party are therefore the same as those available to the contracting party bringing an action for breach of contract, including damages, injunctions and specific performance.

## **Variation and Rescission**

The third party is also protected from variation or rescission of the contract by the contracting parties when he/she has either (a) assented to or (b) relied on a term that confers the rights upon him/her. Specifically, ss. 6(1) and (2) of the Ordinance require contracting parties to obtain the third party's consent in order to so vary or rescind any terms in a contract.

The contracting parties cannot therefore rescind or vary the term without the third party's consent, unless express terms of the contract provide for the contrary and the third party is aware of, or the contracting parties have taken reasonable steps to make the third party aware of, such express terms prior to the third party's assent or reliance.

However, the Hong Kong court has wide discretion to dispense with third parties' consent if the contracting parties agree to rescission or variation and the court thinks that it is just and practicable to do so (ss. 7(2) and (3) of the Ordinance). It is worth noting that the power of the court is not extended to an arbitral tribunal, unlike the equivalent sections in the UK's Contract (Rights of Third Parties) Act 1999.

## **Defences**

The Ordinance also provides for defences, set-offs and counterclaims to be available to the promisor in proceedings brought by a third party to enforce a term of a contract (ss. 8(2) and (3) of the Ordinance). In short, the promisor may raise a matter that would have been available to him by way of defence or set-off as if the third party had been a party to the contract.

However, the availability of such defences is subject to any express term restricting their availability (s. 8(4) of the Ordinance).

## Jurisdiction

Pursuant to s. 13 of the Ordinance, contracting parties should expressly stipulate in the contract whether a third party is bound by an arbitration and/or exclusive jurisdiction clause.

## KEY CONCERN

### Ambiguity of term "purposes to confer a benefit"

A major concern with the Ordinance is the uncertainty around the phrase "purposes to confer a benefit". This may make negotiating commercial contracts more complex, as parties would need to carefully identify all potential third parties and specify which parties are intended to receive the benefit.

If in doubt, contracting parties should consider updating their contracts and their terms and conditions to include an express clause providing that the Ordinance does not apply to the contract or those terms and conditions if they wish to opt out of the application of the new legislation.

In this way, the doctrine of privity of contract can be preserved in their contract even under the new regime.

## CONCLUSION

The Ordinance represents a long awaited reform to Hong Kong's contract law and brings it in line with other common law jurisdictions.

Given the potential implications of the Ordinance on commercial agreements of all kinds, companies shall bear in mind the effects of the Ordinance in their contractual relationships.

However, the ability to "opt out" of the effect of the Ordinance enables parties to preserve the current doctrine of privity of contracts. Such "opt out" clauses have become normal provisions in standard agreements in jurisdictions such as the United Kingdom, meaning that the effect of the Ordinance may in practice be limited.

Click [here](#) to view a copy of the Ordinance.

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